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REPORT
99-259

MALT BEVERAGE INTERBRAND COMPETITION ACT

MARCH 13 (legislative day, MARCH 10), 1986.—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

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REPORT

[To accompany S. 412]

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MINORITY VIEWS

The Committee on the Judiciary, to which was referred the bill (S. 412) to clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

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I. PURPOSE

The design of S. 412 is to provide a threshold test for the application of the antitrust laws to territorial provisions contained in licenses to distribute and sell trademarked malt beverage products.

S. 412 provides that the traditional territorial malt beverage franchise system is lawful under the antitrust laws so long as there

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is "substantial and effective" interbrand [1] competition. If, however, it can be established in a court of law that there is not substantial and effective interbrand competition in a defined geographic area, the provisions of this bill shall not apply. The committee believes that without the enactment of this legislation, the malt beverage industry will, at a minimum, be forced to endure the uncertainty and confusion generated by lower court and agency decisions as these bodies seek to apply the precedent established by *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977); and in the worst cases, be forced to defend against meritless anti-trust accusations. Adoption of this bill is likely to lower costs of distribution while competition among distributors forces lower costs to be passed to the consumer. This bill would extend Congress' successful experiment in soft drink distribution—initiated by the Soft Drink Interbrand Competition Act of 1980—to malt beverages.

This committee is mindful that the balancing of complex economic and social values of the kind involved here is the proper function of the Congress.[2] We have determined that the possible benefits of this bill are substantial in protecting legitimate distribution practices (i.e., nonprice territorial restraints) from challenge. The risks are, on the other hand, insubstantial since effective competition—the threshold requirement for the operation of S. 412—prevents these clauses from being misused. We conclude that adoption of this bill serves the public interest.

Through an exhaustive hearing process the committee reviewed various arguments on the merits of S. 412 and its predecessors. Both the proponents and opponents were given a full opportunity to state their views. The committee has concluded that the present territorial franchise system in the malt beverage industry will continue to foster competition in an already competitive industry. Just as the level of competition has intensifed in the soft drink industry after Public Law 96-308 was enacted in 1980, the level of competition is likely to rise in the malt beverage industry.

The committee finds that this legislation sets a clear and concise standard for determining the legality of vertical nonprice restrictions on the distribution of malt beverages. This standard has provided a simple and easily applied legal rule for the soft drink industry and is equally applicable to malt beverages. In addition, S. 412 enhances state control over the distribution of alcoholic beverages; facilitates the full collection of excise taxes on malt beverage products; and insures that a wide selection of high quality malt beverage products will continue to be available to the consumer. Thus, the Committee on the Judiciary approves this legislation to aid in the administration of antitrust laws and to benefit the con-

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[1] Interbrand competition takes place among products of different brands. Intrabrand competition, on the other hand, involves competition among products of the same brand sold by different vendors.

[2] "If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in other portion, this . . . is a decision which must be made by Congress and not by private forces or by the courts. Private forces are too keenly aware of their own interests in making such decisions and courts are ill-equipped and ill-situated for such decision making. To analyze, interpret, and evaluate the myriad of competing interests and the endless data which would surely be brought to bear on such decisions and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required." *United States* v. *Topco Associates, Inc.*, 405 U.S. 596, 611-12 (1972) (Marshall, J.).

sumer by providing for continued vigorous competition among malt beverage products.

II. TEXT OF S. 412

A BILL TO CLARIFY THE CIRCUMSTANCES UNDER WHICH TERRITORIAL PROVISIONS IN LICENSES TO DISTRIBUTE AND SELL TRADEMARKED MALT BEVERAGE PRODUCTS ARE LAWFUL UNDER THE ANTITRUST LAWS

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Malt Beverage Interbrand Competition Act".

SEC. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any written contract in effect on or entered into after the effective date of this Act by any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage with any wholesale distributor of provisions granting the wholesale distributor the sole and exclusive right to distribute and to sell such product in any defined geographic area within any State and limiting such exclusive distributor to the distribution and sale, directly or indirectly, of such product only for ultimate resale to consumer within that defined geographic area when such product is in substantial and effective competition with other malt beverage products within that defined geographic area.

SEC. 3. Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act in any written contract described in that section by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints, or boycotts would otherwise be unlawful.

SEC. 4. As used in this Act, the term "antitrust law" means the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (Sherman Act), approved July 2, 1890, the Federal Trade Commission Act, approved September 26, 1914, and the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (Clayton Act), approved October 15, 1914, and all amendments to such Acts.

SEC. 5. As used in this Act, "malt beverage" shall mean and include beer of all types and varieties as defined in any Federal or State statute, ale, porter, stout, and all other similarly designated fermented beverages containing one-half of 1 per centum or more alcohol by volume.

SEC. 6. As used in this Act, the term "State" includes the District of Columbia and any territory or possession of the United States.

SEC. 7. This Act shall not invalidate any provision of the laws of any State.

III. NEED FOR LEGISLATION

A. Overview of the malt beverage distribution system

Malt beverages are distributed to consumers through a three-tiered system composed of: brewers, beer wholesalers, and retailers. Since S. 412 focuses on preserving the existing and competitive

wholesale distribution system, it is necessary to concentrate upon the beer wholesaler in examining the Malt Beverage Interbrand Competition Act.

Most established local beer wholesalers, in serving their defined territories, must abide by the requirements specified in their territorial distribution contracts. In general these contracts provide that wholesalers must service all outlets in their defined territories regardless of size or volume of sales. Wholesalers are required to inspect and replace all overaged products and damaged merchandise at their expense. They are also required to fully promote the products they are responsible for distributing and to participate in civic and charity functions. This often requires the wholesaler to service, among others, rural communities where the money expended in maintaining a fresh, high quality beer supply often outweighs the profit gained from these rural markets.

Most brewers assign specific territories to wholesalers to assure full attention by that wholesaler to the needs of his retailers and the ultimate consumers. This system gives rise to uniform product quality, the full promotion of products, and healthy competitive pressures.

Many states bear witness to the beneficial purposes of S. 412. Exclusive territorial distribution systems are mandated in twenty two states. In some states those distribution sytems have been sucessfully operating for over fifty years. Under S. 412 each state will continue to be free to choose its own particular distribution system.

B. The need for a threshold test for antitrust challenges

Uncertainty and confusion have been the hallmark of the antitrust laws as applied to nonprice vertical restraints. In 1977 the Supreme Court reversed a ten-year old doctrine that had made it automatically illegal for manufacturers to restrict the territories in which their distributors or dealers sold their products. The Court held in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977), that nonprice vertical restrictions are to be evaluated under a rule of reason test. The court recognized that several significant efficiencies could be achieved by distribution restrictions. Among the efficiencies cited by the Court are retailer and distributor investments, promotional activities, and quality controls.

Unfortunately, the Court provided virtually no guidance to subsequent courts as to how the rule of reason is to be applied. The Court quoted at length from a famous but ambiguous statement by Justice Brandeis (in *Chicago Board of Trade* v. *United States*, 246 U.S. 231 (1918)) identifying the elements of a rule of reason analysis. This has produced a welter of often frivolous cases and a variety of confused legal standards. As commentators of diverse policy views have agreed, the *Sylvania* Court's listing of the factors that a court should take into account in evaluating territoral agreements does not provide useful instruction on how the test is to work. In fact, it is not even clear what the "rule of reason" means.

This case law confusion has provided lower courts with a steady diet of cases raising the question: what is the standard of proof in a non-price vertical restriction—i.e., rule of reason—case? In general, lower courts, (*Valley Liquors, Inc.*, v. *Renfield Importers Limited*, 678 F.2d 742 (7th Circuit) (1972, *Graphic Products Distribution* v.

Itek Corp., 717 F.2d 1560 (11th Circuit) (1983)), have focused on the central issue of whether non-price vertical restriction could in any way seriously limit interbrand competition. These courts often examine market shares and the likelihood of competition among manufacturers and wholesalers. But numerous side issues can be raised by the parties in rule of reason litigation, and these cases are often lengthy and costly.

Business must, however, grapple with a somewhat different question. Specifically, they must weigh the risk of agreeing to territorial restrictions in the distribution of a product or service against becoming engaged in one of hundreds of costly private antitrust suits filed annually. The great number of antitrust challenges makes this risk appear increasingly substantial even though plaintiffs seldom prevail. The costs imposed on wholesalers and brewers are often similar whether or not the challenge is serious. For example, in 1983, all wholesalers and brewers were used in a class action in New Jersey by a few retailers claiming that exclusive territories and other business practices violated the antitrust laws. While this case was ultimately dismissed it illustrates the problems created when there is no minimum standard for determining the existence of serious threats to competition.

As this Committee found when recommending the Soft Drink Interbrand Competition bill five years ago, the threat of lawsuits by disgruntled retailers or terminated dealers and distributors whose performance fails to meet competitive standards now impose substantial costs on producers, wholesalers, consumers and society. Litigation costs escalate; litigation burdens overwhelm courts and results in higher prices; and the consumer is ill served. The case law confusion and its uncertain rule of reason standard have combined to encourage frivolous lawsuits that dampen competition and curtail dealer investment in promoting products or services.

S. 412 is a direct response to these problems. It would establish a minimum test for analyzing antitrust claims based on vertical nonprice restrictions and for eliminating those claims that are not based on restrictions that pose a threat to consumers or competition. It provides that, where "substantial and effective competition" exists among malt beverages in the area affected, territorial restrictions are permissible under the antitrust laws. While this result is, in fact, not very different from several lower court interpretations of the rule of reason standard, *Daniels* v. *All Steel Equipment, Inc.*, 590 F.2nd 111 (5th Circuit) (1979), *Kestenbaum* v. *Falstaff Brewing Corp.*, 575 F.2nd 564 (5th Circuit) (1978), cert. denied, 440 U.S. 909 (1979), this proposed legislation would uniformly simplify and shortcut today's costly and cumbersome antitrust processes for all tribunals. Under S. 412 the initial question before the trial court would simply be whether competition exists in the given market. If so, the restriction would be deemed to satisfy the antitrust requirements. If not, the usual antitrust rule of reason would be applied.

The basis for this simple legal test is straightforward yet powerful. Where substantial and effective competition exists among malt beverages (i.e., on the interbrand level), the inclusion of nonprice vertical restraints such as exclusive territories in contracts between a brewer and its distributors cannot adversely affect inter-

brand competition. These restraints can only affect competition among wholesalers of the same brand—that is, on the intrabrand level. Such restraints increase a wholesalers competition with wholesalers of the other brands of beer. A brewer will adopt such restrictions to encourage distributors to do a better job of promoting, distributing and servicing their product. Competition among beers will be intensified by the existence of such contractual restrictions. If territorial exclusives were to become inefficient and raise costs, brewers would be "punished" by competitors. It is for this reason that the "substantial and effective competition" test was stated as the standard for S. 412. Where such competition exists the restraint cannot impair competition and there is no need or purpose in further applying the antitrust laws. Antitrust trials and their costs should be limited in testing nonprice vertical restraints to those situations where competition is not present. Instead of allowing the threat of interminable antitrust lawsuits to chill interbrand rivalry, judicial challenges to territorial clauses could be quickly considered. Frivolous claims that would not, in fact, survive S. 412's threshold test would either disappear or could be readily dismissed. Likewise, where substantial competition is not present, the antitrust rules as set forth in *Sylvania* would continue to apply.

S. 412 does not modify or otherwise alter the rule of reason standard. It simply identifies when it is appropriate to hold an antitrust trial. Thus, it provides that the antitrust law and its accompanying complex rule of reason standard would be applied only where there is a possibility that the vertical restraint poses a threat because substantial competition is not present.

Not only is this two step-process consistent with *Sylvania*, but it also furthers the Court's purposes. In *Sylvania* the Court abandoned a test of per se illegality for nonprice restriction because territorial clauses and similar vertical restraints were likely to strengthen competition. Protecting dealers from intrabrand rivalry of dealers of the same product could, the Court reasoned, result in lower distribution costs, attract effective distributors, increase retail distributor loyalty and support.

The purpose of S. 412 is to simplify and strengthen the legal system by drawing a readily understood and easily administered dividing line for deciding whether the benefits of territorial restrictions will clearly outweigh any costs. When the manufacturer's product faces rigorous competition, territorial restrictions cannot be used to enforce a price cartel by either manufacturers or dealers. Competition will prevent a cartel from succeeding by offering competitive products at a lower price with better quality, and superior quality controls. Thus, where competition is present, the territorial provision serves the competitive ends that *Sylvania* wisely sought to preserve.

IV. SECTION-BY-SECTION ANALYSIS

A. Section 1: Title

The title of this act is the Malt Beverage Interbrand Competition Act.

B. Section 2: Test of legality

S. 412 amends the antitrust laws to clarify the circumstances under which exclusive territorial licenses to distribute and sell trademarked malt beverage products shall not be deemed unlawful. It is the committee's intent and purpose to provide that if the requirements of S. 412 are met, the relevant territorial distribution provisions are lawful. Nothing in this bill is intended to protect any other provision in such trademark licensee, or any other practice or conduct of licensors or licensees of trademarked malt beverage products from challenges under the antitrust laws. Further, this legislation is to apply only to arrangements in which a trademark owner grants licensees the right to distribute and sell trademarked malt beverage products within defined geographic areas. Finally, this bill is to apply only when a product is in substantial and effective competiton with other malt beverage products within that defined geographic area.

It is the committee's intent to preserve the present system of malt beverage distribution and sale. Therefore, this bill makes lawful license provisions which have the effect of precluding indirect evasions of the license agreement. Thus, the exclusive territorial rights of one licensee are protected from direct or indirect sales by the licensor or any other licensees into his defined geographic area. This is true unless the infringing licensee, or other party with standing, can establish that there is not substantial and effective competition within the geographic area at issue and this accusation is not successfully rebutted by the defendant.

The operative language of S. 412, that "substantial and effective competition" exists, adopts a practical standard and assures that protected territorial restrictions would serve the public interest. The standard is identical to that adopted in the Soft Drink Interbrand Competition Act and authoritative decisions under that law are fully applicable herein. It requires that for this bill to apply to a territorial restraint in a beer distribution agreement, that product shall face substantial competition from other malt beverage products.

In applying the substantial and effective competition standard, a court must consider numerous factors. While there is no single, universally accepted standard by which to test the level of interbrand competition, a court would consider the number and strengths of the firms in the market; the distribution and stability of the market shares; the ease with which other firms can enter the market; the likelihood of such entry; evidence of rivalry on price, service and quality; changes in market shares and price and similar indicia of competition. These are standard antitrust questions familiar to courts and lawyers, particularly in antitrust cases tried under Sections 3 and 7 of the Clayton Act.

Under S. 412, however, the issue before the court would not be whether there has been a "substantial lessening of competition," as the Clayton Act inquires, but only whether substantial and effective competition exists. The trial court would not be asked to measure the degree to which competition was enhanced or impaired, but only whether it was present. We are persuaded that this threshold

issue could be decided in most instances after a brief one-day hearing and argument.

In the committee's opinion this threshold test to the application of complex antitrust proceedings is necessary to clarify the application of the rule of reason standard. S. 412 seeks to remove the uncertainty generated by court and agency decisions. It would assure the stability and continuity of the Supreme Court's ruling in *Sylvania* that nonprice vertical restraints violate the anti-trust laws only when they threaten the public interest. Where territorial restrictions are likely to improve distributional efficiency, they would be protected.

C. Section 3: No special treatment under antitrust law

This section clearly states that S. 412 is not intended to immunize or exempt dangerous practices from antitrust challenges. This bill would not protect or in any way affect price-fixing agreements, horizontal restraints, group boycotts, vertical price fixing, or any other activity subject to antitrust review. S. 412's scope is limited to providing direction to the courts and providing a threshold test in evaluating the antitrust consequences of vertical territorial restrictions in distribution agreements. This section reflects that the purpose of this bill is to clarify circumstances under which it is appropriate to apply the antitrust laws. It is neither an exception nor exemption from the antitrust laws.

D. Section 4: Antitrust law defined

This section defines the words "antitrust law" to include the Sherman and Clayton Acts, all amendments to such acts, and any other laws pertaining to the same subject. This definition is consistent with similar definitions in section 1 of the Clayton Act and section 4 of the FTC Act.

E. Section 5: Malt beverage defined

This section is simply intended to demonstrate the types of beverages to be affected by S. 412.

The definition of malt beverage is consistent with the definitions contained in the Federal Alcohol Administration Act which is recognized as the law governing federal regulation of alcoholic beverages.

F. Section 5: State defined

This section makes it clear that S. 412 is to apply to ail states, the District of Columbia and any territory or possession of the United States.

G. Section 7: State laws not affected

This final section explains that S. 412 will in no way alter existing state laws and regulations. While S. 412 allows exclusive territorial agreements for beer wholesalers under federal law, states retain the right under the 21st amendment to choose how malt beverage distribution is to be managed in a given state.

V. LEGISLATIVE HISTORY

Legislation similar to S. 412 and pertaining to territorial agreements has previously been introduced in both the 97th (H.R. 3269, H.R. 3996, H.R. 4189, H.R. 4320 and S. 1215) and the 98th (H.R. 2262 and S. 1680) Congresses. On February 6th of this year, Senator Goldwater introduced S. 412, the Malt Beverage Interbrand Competition Act, with the support of 22 of his colleagues. Shortly thereafter, Congressman Brooks introduced H.R. 1108 as a companion bill to S. 412 and has subsequently introduced H.R. 3793 which seeks to make improvements to the language contained in S. 412. While no hearings have been held on either H.R. 1108 or H.R. 3793, two hearings preceded the October 3 markup of S. 412. Full Senate Judiciary Committee hearings were held and chaired by Senator Thurmond on May 14, 1985 and October 2, 1985.

On October 31, 1985, the full committee defeated by voice vote the following five amendments:

Amendment to S. 412 by Senator Metzenbaum

On page 2, line 8, strike out all after "area" through the end of the section and insert: "unless the anticompetitive effects from such an agreement outweigh the procompetitive effects."

Amendment to S. 412 by Senator Metzenbaum

At the appropriate place in the bill, add the following new section:

> Nothing in this Act shall be construed to provide a standard of legality for exclusive territorial arrangements for wholesale distributors of malt beverages that is different from that applicable to sellers of any other product; nor shall any provision in this Act be construed to modify the legal standard for assessing such arrangements for such distributors prevailing immediately prior to the enactment of this Act.

Amendment to S. 412 by Senator Metzenbaum

On page 2, line 10, delete the period and add the following: "provided that this section shall not apply if the combined market share of the four largest wholesale distributors in a relevant market exceeds 50 per centum of total sales in such market."

Amendment to S. 412 by Senator Simon

At the appropriate place in the bill, add the following new section:

> SEC. . For purposes of determining whether a product is in competition with other malt beverage products in the relevant market or markets, no such competition shall be deemed to exist to the extent such products are distributed by the same distributor.

Amendment to S. 412 by Senator Metzenbaum

On page 2, line 10, delete the period and add the following: "provided that this section shall not apply to determining the legality under the antitrust laws of any restriction on a wholesale distributor selling product to a customer who takes delivery of the product in such distributor's territory."

The Committee then reported S. 412 by voice vote with a recommendation that it be passed by the Senate. The report was filed on March 13, 1986.

VI. REGULATORY IMPACT STATEMENT

Pursuant to paragraph II(b), Rule XXVI of the Standing Rules of the Senate, the Committee has concluded that the Act will have no direct regulatory impact.

VII. COST OF LEGISLATION

In accordance with paragraph II(a) of Rule XXVI of the Standing Rules of the Senate and Section 403 of the Congressional Budget Act of 1974, the Committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, November 15, 1985.

Hon. STROM THURMOND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 412, the Malt Beverage Interbrand Competition Act, as ordered reported by the Senate Committee on the Judiciary, October 31, 1985.

S. 412 would clarify the criteria used to determine whether or not sufficient competition for beer sales exists in particular markets. Based on information from the Department of Justice and the Federal Trade Commission, this change affecting antitrust laws is not expected to result in any significant cost to the federal government.

No costs would be incurred by state or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,

Sincerely,

JAMES BLUM,
(For Rudolph G. Penner).

MINORITY VIEWS OF SENATORS THURMOND, DENTON, KENNEDY AND METZENBAUM ON S. 412

INTRODUCTION

The Malt Beverage Interbrand Competition Act, S. 412, would make an industry-specific change in the legal standard to be applied to the use of exclusive distribution territories. Such a change would be highly undesirable because it would make it easier for beer distributors to protect local monopolies. At the very best, the bill is simply an unnecessary restatement of existing law. While the supporters claim on several occasions that S. 412 does not modify or is "not very different from" the current antitrust standard, much of the majority report clearly reveals that this bill is intended to establish significantly different treatment for one line of business—beer wholesaling. The majority report sets forth no case or reason for conferring such an extraordinary privilege on this industry; S. 412 is truly a bill without a need.

In order to understand why enactment of S. 412 would be a mistake, it is important to know what the current legal standard is and how it now applies to beer wholesaling. The current antitrust analysis of all agreements between suppliers and distributors—except those relating to resale prices—is governed by the Supreme Court's decision in *Continental T.V., Inc.* v. *GTE-Sylvania, Inc.*, 433 U.S. 36 (1977). In the *GTE-Sylvania* case, the court held that exclusive territories and other nonprice vertical restraints of trade are to be judged under the "rule of reason." That means, among other things, that such arrangements are not per se illegal (i.e., deemed to be unreasonable without further inquiry). Instead, agreements between suppliers and distributors, or between wholesalers and retailers, which set nonprice conditions for the resale of products, are presumed to be lawful until it is proven that they unlawfully injure competition.

Even though, by definition, they restrain competition among distributors of the same brand to some degree, nonprice vertical agreements violate antitrust law only if their adverse effects outweigh their competitive benefits. In other words, only if it is determined that a vertical restraint has a net anticompetitive effect is the restraint unlawful, under the existing standard. Under existing rule-of-reason analysis, all economic factors affecting competition are examined in evaluating the competitive effects of vertical restraints, including the business justifications for the use of such restrictions. Significantly, one of the factors currently considered in the analysis of exclusive territories is the degree of competition that exists among the different manufacturers of different brands of products in the relevant market. In light of the broad scope of this analysis, there is no basis for the proponents of S. 412 to con-

tend that the rule-of-reason standard gives insufficient weight to proffered justifications for exclusive territories.

The operative provision of S. 412 would provide that nothing contained in any federal antitrust law shall render unlawful exclusive territorial agreements in any written contract between a wholesale distributor and any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage, so long as the malt beverages covered by such agreements are in "substantial and effective" competition with other malt beverage products within a defined geographic area. Since, as previously noted, the current rule of reason already takes account of the degree of competition facing the manufacturer who uses exclusive territories for distribution, the new standard contained in S. 412 is superfluous and unnecessary at best. If it is intended only to clarify the current law, the new standard would fail to do so because it would be no clearer than the current rule-of-reason test; it can only add uncertainty to antitrust analysis. Unfortunately, it appears that the real purpose of S. 412 is to do more than clarify the current standard; in fact, the Committee rejected amendments that would have merely clarified that the rule of reason applies to beer-distribution exclusive territories. Instead, the true purpose of the bill appears to be to grant the malt beverage industry an unjustified exemption from the antitrust laws and to make it extremely difficult to challenge successfully any territorial monopolies in beer wholesaling.

Since, under the current rule of reason, applicable to all industries, exclusive territorial restraints are lawful unless they are proven to be anticompetitive and injurious to consumers, we must ask why more lenient treatment is necessary and appropriate for restrictions in the malt beverage industry. Why is it desirable to alter the legal standard to legalize what currently fails that standard as anticompetitive and injurious to consumers? The only semibalance of a case for enactment of S. 412 appearing in the majority report is that the bill would spare parties in the malt beverage industry the litigation expenses of defending the presumed legality of their territorial restrictions. The bill's proponents complain that the members of the beer wholesaling business must now "endure the uncertainty and confusion" about the rule-of-reason standard and at worst must "defend against meritless antitrust accusations." The Committee report suggests that large number of frivolous cases are tried under an unclear rule-of-reason test, but there is no such evidence in the legislative record of this bill. While the bill's supporters acknowledge that, under the rule of reason, the courts now look at such factors as market shares and competition among brands, they complain of the "side issues" that can arise in rule-of-reason litigation. The report alleges that the threat of suits under the current rule of reason actually chills interbrand competition. Yet the only suit cited in the beer wholesaling business was dismissed. The fact is that no legal standard can prevent suits from being filed. The real effect of S. 412, though, would be to make it almost impossible for private parties or antitrust enforcement agencies to prove that truly harmful exclusive territories violate antitrust law.

THE NEW STANDARD WOULD NOT CLARIFY THE LAW

Vertical restraints analysis would not be made any easier or clearer by substituting the new phrase, "substantial and effective competition." The interpretation and application of this new test in litigation would involve the same costs and the same, if not more, uncertainty as those incurred in the application of the current rule of reason. As a distinguished antitrust lawyer testified on behalf of the American Bar Association,

> No one knows what the new standard means. And it must be a new standard; otherwise the bill is unnecessary. (Testimony of Richard A. Whiting, Chairman of the Section of Antitrust Law of the American Bar Association, May 14, 1985)

The proponents claim to have struck upon a new bright-line test "for deciding whether the benefits of territorial restrictions will clearly outweigh any costs." In fact, this sounds like a restatement of the rule of reason. If this claimed jurisprudential improvement is in fact what S. 412 would accomplish, why is its application confined to beer wholesaling restrictions?

The answer is that, in reality, S. 412 sets up a special, more lenient standard of antitrust law only for members of the beer distribution business. According to the majority, under that standard, a "court would not be asked to measure the degree to which competition was enhanced or impaired [by a restraint of trade], but only whether it [i.e., competition] was present." In other words, instead of judging a restraint's effects on competition by the amount by which competition is reduced, under S. 412 the courts would be allowed to look only at how much competition is left. Arguably, this new standard could immunize all territorial restrictions except those imposed by a monopolist. While the exact meaning of the new standard is murky, it is clearly a deviation from current antitrust standards. As Mr. Whiting pointed out on behalf of the American Bar Association, "it is probably not an exaggeration to say the legislation is designed to confer *per se* legality on exclusive territorial arrangements in the malt beverage industry." (Testimony of Richard A. Whiting, Chairman of Antitrust Law, May 14, 1985).

The only way that the new standard could save litigation costs is to omit from the current legal analysis one or more of the steps, factors or inquiries that are presently part of the rule-of-reason. By deleting those inquiries, the new standard would certainly not amount to recodification or clarification, but would amount to the creation of a more lenient analytical standard. Therefore, the new standard would probably reduce litigation costs only by changing the law to legalize restraints that would presently violate the antitrust laws.

S. 412 WOULD CONFER SPECIAL-INTEREST ANTITRUST IMMUNITY

Vertical restraints are lawful unless their anticompetitive effects outweigh their procompetitive effects. To confer a more lenient standard on certain vertical restraints in a particular industry would not amount to a clarification of law, but would constitute a grant of a special antitrust exemption for the industry. As the De-

partment of Justice has pointed out, the special treatment conferred by S. 412 runs counter to the deregulatory trend in Congress to narrow existing antitrust immunities. Congress has preferred to rely more heavily on competition even in highly regulated industries. This trend is highly evident in the airline, trucking and rail industries and is currently taking place in the telecommunications and financial-institution industries. "Establishment of an antitrust standard for the malt beverage industry different from that applicable to other industries would be inconsistent with this desirable trend." (Testimony of Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice, May 14, 1985).

THERE IS NO REASON OR NEED FOR SPECIAL TREATMENT FOR THE BEER INDUSTRY

The malt beverage industry has offered, as support for this bill, several justifications for its use of exclusive territories. Even assuming that those justifications are valid, efficiency-enhancing reasons for imposing vertical restraints, they simply do not require the protection of new legislation. To reiterate what must be said often in this report, the current antitrust standard already takes into account a supplier's reasons for imposing vertical restraints, and suppliers are permitted by law to set up distribution systems using such restraints if, on balance, the restraints promote competition or have a neutral net effect on competition. Accordingly, this legislation is not necessary.

It has been argued that this legislation is necessary to insure that the industry can curb "transshipment", which is the practice by wholesalers of reselling outside their assigned territories. It is further argued that this bill is necessary to insure that distributors adequately cover their territories in order to avoid the sale of stale beer, a practice that reflects adversely on a brewer's brand image. Yet these justifications are already cognizable under the rule-of-reason standard. If vertically-imposed restrictions on transshipment do in fact enhance competition among different brands of beer by insuring the proper servicing of sales areas and proper rotation of stock to avoid sales of stale beer, the antitrust laws unquestionably take into account those procompetitive justifications. The law simply does not prevent the supplier's adoption of reasonable restrictions for the purpose of insuring delivery of high-quality products. The witness from the Federal Trade Commission confirmed this point by indicating that the Commission has modified a series of orders over the past year specifically in order to permit sellers' imposition of restrictions on transshipments that are intended to enhanced a seller's competitive position.

AN ANTITRUST EXEMPTION FOR THE MALT BEVERAGE INDUSTRY IS ESPECIALLY INAPPROPRIATE

A number of well-informed witnesses indicated that the malt beverage industry is not an industry deserving lenient antitrust treatment, but is an especially inappropriate recipient of a special antitrust exemption. Even though vertical restraints can produce procompetitive effects, witnesses from the Department of Justice and Federal Trade Commission pointed out ways in which vertical

restraints can also produce net anticompetitive effects; they pointed out that many of the preconditions for such an outcome exist in the malt beverage indutry. The Justice Department described three conditions under which exclusive territories can create a significant anticompetitive threat: high concentration in the manufacturing market; the use of the restraint to distribute a large percentage of the total sales of the product; and the absence of easy entry. As the Federal Trade Commission pointed out,

> The malt beverage industry exhibits the structure characteristics that increase the risk that exclusive territorial arrangements will be used in an anticompetitive manner. The brewing industry is quite highly concentrated. Four firm concentration in beer brewing increased at the national level from 46 per cent in 1970 to 77.9 per cent in 1983. Moreover, in most states, four firm concentration exceeds 80 per cent. We also understand that wholesale concentration is high—perhaps higher than brewing concentration—though we do not have reliable data on the structure of the malt beverage wholesale distribution sector. [Note: Virtually all brewers use exclusive territories; in many markets, different brewers use the same wholesaler.] Finally, we understand that the laws of many states create entry barriers that restrict entry into the wholesale distribution of malt beverages. (Testimony of Walter T. Winslow, Deputy Director, Bureau of Competition, Federal Trade Commission, May 14, 1985.)

It was pointed out that exclusive territories can, in some circumstances, facilitate collusion among competing manufacturers or distributors. If there are regulatory barriers to the creation of additional dealers, distributors may be able to use exclusive territorial franchising as part of a scheme to eliminate competition. If there is only one distributor, or very few distributors, in an area and the State established barriers to the establishment of additional dealers, eliminating competition from distributors in areas by the use of exclusive territorial franchises may permit the distributor or distributors to charge monopoly prices without fear of additional competition. The probability of such anticompetitive conduct depends on the structural conditions of the industry in question. In an industry with a small number of competitors, high concentration, and high barriers to entry, the risk of successful collusion is enhanced.

Accordingly, the market characteristics that might permit vertical restraints to produce net anticompetitive results are found in the malt beverage industry. Yet this legislation, in illogical fashion, would render it more difficult for antitrust law enforcers to challenge monopolistic behavior in this industry than in other industries. The witness from the Consumer Federation of America predicted that this legislation would only extend lawful status to anticompetitive territorial restriction.

> Territorial restrictions which reduce competition will not meet the standards laid down by the Supreme Court in *GTE-Sylvania*. Thus, if the brewers and beer wholesalers

foresee that their proposed system of distribution monopolies will raise prices and further concentrate the industry, then they must seek legislation—because their arrangement would not survive antitrust challenges in the federal courts. (Testimony of Stephen Brobeck, Executive Director, Consumer Federation of America, May 14, 1985).

The proponents of S. 412 may point to Section 3, the provision of the bill preserving challenges to the enforcement of exclusive territories by horizontal restraints, as a kind of antitrust "saving clause." As the distinguished witness representing the American Bar Association points out, however, section 3 of the bill does not provide antitrust enforcers with the proper statutory tool for attacking vertical restraints that yield anticompetitive consequences.

> It does not address the real concern with exclusive territories—that if used by firms with sufficient market share (whether or not enforced by horizontal agreements), they may facilitate collusion, permit the exercise of market power, or otherwise foster anticompetitive behavior. The only effect of the bill can be to protect those systems which would not pass muster under the rule of reason. (Testimony of Richard A. Whiting, Chairman of the Section of Antitrust Law of the American Bar Association, May 14, 1985).

The only conclusion to be drawn from this record is that S. 412 is intended to do more than clarify the application of the current rule-of-reason standard to exclusive beer distribution territories. It is apparently intended to afford lenient treatment to arrangements in this industry that would be condemned as unreasonable and anticompetitive under the unquestionably flexible standard of law applicable to all other industries. For the reasons described above, the malt beverage industry is an especially unsuitable candidate for this special leniency.

CONDITIONS IN THE BEER INDUSTRY ARE SUBSTANTIALLY DIFFERENT FROM CONDITIONS LEADING TO SOFT DRINK LEGISLATION

The proponents of S. 412 argue that legislation similar to this bill was deemed appropriate for the soft drink industry and enacted into law in 1980. They further contend that the circumstances that warranted enactment of the soft drink measure exist in the malt beverage industry. However, the record and testimony before this Committee belie such a claim. Indeed, the evidence compiled by the Committee distinguished the malt beverage industry in several important and material respects from the soft drink industry as it existed at the time of enactment of the Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03 (1980). In fact, it is particularly significant that former Senator Birch Bayh, the author and principal Senate sponsor of the soft drink legislation, appeared before the Committee to point out the distinguishing features of the soft drink and malt beverage industries. His testimony warrants extensive quotation:

> To the extent that the supporters of the Malt Beverage bill advocate its passage on the grounds that it "is just like

the Soft Drink bill", I should note, with all respect for the good intentions of the supporters, that there are significant differences between the two industries and the circumstances which prompted Congressional consideration of the legislation. Specifically:

The structure of the two industries is different.

The economic impact of the two industries' local facilities upon the various communities in which they are located is quite different.

The Constitutional authority and precedent for regulating the two industries are different.

The legal environment in which the malt beverage industry is operating today is much different than the legal environment which confronted the soft drink industry in 1980.

Congress did not intend for the Soft Drink legislation to be utilized as a precedent for any subsequent legislation.

(Testimony of Honorable Birch Bayh, Former United States Senator, October 2, 1985.)

An elaboration of these distinctions made by Senator Bayh would be instructive. First, with respect to the structure of the industries, there is a high degree of concentration in the malt beverage industry which has been described previously. While concentration in the soft drink industry is also relatively high, that industry is not characterized by governmentally imposed barriers to entry that could impede the marketplace solution of competitive problems. In the soft drink industry, the bottlers, who are also distributors, are engaged in production. The bottlers arguably need to be tightly controlled and to have their relatively expensive investments in plant and equipment protected from intrabrand competition. In the malt beverage industry, by contrast, wholesalers do not participate in production of the products. While the malt beverage wholesalers typically have investments in warehouses and trucks, their investments are generally smaller than those made by soft drink bottlers in plants and equipment. Because of these differences in production roles, local soft drink bottling facilities have a different economic impact on their communities than wholesalers of malt beverages.

In addition, under the Twenty-first Amendment to the Constitution of the United States, the malt beverage industry is the subject of extensive state and local regulation and control which is not applicable to the soft drink industry. While additional antitrust law implications of this pervasive scheme of regulations will be discussed below, it is sufficient to note at this point that there is a distinct Constitutional authority for regulation of alcoholic beverage markets that differs from anything applicable to the soft drink industry.

A particularly significant distinction between the soft drink bill and S. 412 is the difference in the legal environments of 1980 and today with respect to vertical restraints. Between 1963 and 1977, the analytical standard applicable to nonprice vertical restraints was changed no less than three times by the Supreme Court. In the few years after the *GTE-Sylvania* decision in 1977, there may well

have been significant uncertainty about the legal test applicable to exclusive territories in the soft drink industry. No such uncertainty about the applicability of the rule of reason to exclusive territorial agreements in any industry exists today; there is simply no need for clarification. Neither are there any pending or recent antitrust cases that can be perceived or cited as jeopardizing the use of exclusive territories in the malt beverage industry. As Senator Bayh said,

> Indeed, as far as I know, there has been no successful private antitrust suit or proceeding or any kind against the malt beverage industry since before the *GTE-Sylvania* decision in 1977. (Testimony of Honorable Birch Bayh, p. 6, October 2, 1985).

Finally, in response to those who would cite the soft drink legislation as a reason for enactment of S. 412, former Senator Bayh testified that the 1980 legislation was considered unique, warranted only by the peculiar circumstances in the soft drink industry at that time, and never intended as a precedent for other industries.

STATE ACTION IMMUNITY

Even beyond these persuasive reasons, there is yet another reason why the Malt Beverage Interbrand Competition Act is at best superfluous and unnecessary. We mentioned that the distribution and sale of alcoholic beverages has been the responsibility of the States for many years. A majority of the States—twenty-seven at last count—have exercised that authority by adopting laws requiring that malt beverages be wholesaled through exclusive territories. The existence of these mandatory exclusive territory laws provides another reason to reject S. 412.

It is clear from the Supreme Court's recent decisions concerning the "state action" doctrine in antitrust law that the States have the power and authority to immunize from federal antitrust liability any persons who properly implement State beer-distribution policies. In *Parker* v. *Brown*, 317 U.S. 341 (1943), the Court refused to apply the Sherman Act to the anticompetitive conduct of a State acting through its legislature. In *California Retail Liquor Dealers Assn.* v. *Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), the Court laid out a two-prong test for applying the state action exemption to private persons. In *Midcal*, the Court held that a private party is shielded by the state action exemption if it can show that it acted pursuant to a clearly articulated and affirmatively expressed state policy and that its conduct is actively supervised by the State. Therefore, where States require the use of exclusive territories for the distribution of malt beverages and meet the standards of *Midcal* (as they very likely do), the private parties whose conduct implements the State policies with respect to alcoholic beverage distribution enjoy state action immunity from federal antitrust law. Thus, the States already possess the power to shield private parties from antitrust liability; whether the States exercise that authority is a matter correctly left to the States.

Where State legislatures mandate and supervise these exclusive territories, S. 412 would provide no incremental protection to the

parties engaged in the conduct contemplated by the States. Where the States have not chosen to enact such laws or have remained neutral on the question, federal antitrust law would be applicable to the use of exclusive territories; but as explained earlier, the antitrust standard applied to such restrictions is the rule of reason.

The proponents of S. 412 seem to suggest concern that State mandatory exclusive territory laws might be invalidated by the supremacy of federal antitrust law. (See testimony of Marion Carnell, p. 5, May 14, 1985). Even that concern is groundless and cannot serve as a justification for this legislation. The Supreme Court has recently confirmed that a state statute can be invalidated by federal antitrust law only if the statute on its face irreconcilably conflicts with federal antitrust policy. Where a state statute permits or requires conduct by a private party that is subject to analysis under the rule of reason, the statute will not be invalidated. To put it another way, a state statute will be invalidated by conflict with federal antitrust law only when the state statute requires private parties to act in a manner that is per se illegal under federal antitrust law. *Rice* v. *Norman Williams Co.*, 458 U.S. 654 (1982). Since the use of exclusive territories is not per se illegal (but is judged by the rule of reason), it is highly unlikely that any State laws mandating exclusive beer distribution territories would be pre-empted or invalidated. The problem simply does not exist, and it is not even a colorable argument for enactment of this legislation. If the States see fit to act with respect to the use of exclusive territories for distribution of malt beverages, they have that authority under current law. This bill is at best an unnecessary and intrusive overcoating to the well-established principles of state-federal relations that govern these matters.

HIGHER PRICES UNDER EXCLUSIVE TERRITORIES

While it is generally recognized, after the *GTE-Sylvania* decision, that the use of many vertical restraints—including exclusive territories—produces results that are procompetitive and beneficial, it is also recognized that in some circumstances the negative effects of vertical arrangements may outweigh the competition-enhancing effects. As we discussed earlier, the antitrust experts who testified before the Committee expressed concern that the malt beverage industry exhibits some of the characteristics of markets in which exclusive territories might produce net anticompetitive effects. The evidence submitted to the Committee substantiates this concern.

The movements of beer prices before and after the imposition of exclusive territories in some markets strongly suggest that the use of such restrictions can, and does, lead to higher prices. For example, the Attorney General of New York submitted data collected from surveys conducted by the New York City Department of Consumer Affairs. Prior to 1983, exclusive territories were not employed by brewers in New York and wholesalers of beer were allowed to ship anywhere in the state, including to New York City. After the two leading brewers adopted exclusive territories in 1983, retail beer prices rose 35.7 percent, compared with soft drink prices of 6.7 percent, the national Consumer Price Index ("CPI") of 10.7

percent, the New York City metropolitan retail CPI of 13.1 percent, the national CPI for food of 8.4 percent and the New York City regional CPI of 9.7 percent. While some of that price rise may have been attributable to the effect of a container deposit law enacted during the relevant period, the deposit law applied equally to soft drinks, the prices of which did not rise nearly as much as beer prices. The witness for the Attorney General of New York testified as follows:

> The logical conclusion drawn by this office from these startling figures is that the grossly disproportionate 35.7 percent beer price increase in a 28 month period was due in large part to the effects of the exclusive territories adopted by Busch and Miller in 1983. (Letter from Lloyd Constantine, Assistant Attorney General, State of New York to Senator Strom Thurmond, May 30, 1985).

The Consumer Federation of America also provided information on the relationship between exclusive territories and beer prices. In Indiana, price reductions of 20 percent have been attributed to the advent of competition among distribution territories in the 1970's. (Testimony of Stephen Brobeck, Executive Director, Consumer Federation of America, May 14, 1985.)

An illustration of the potential price-increasing effect of exclusive territories was provided by a South Carolina food retailer. He testified that his wholesale supplier of Budweiser charges him $11.20 per case. He knows of another wholesale distributor in South Carolina who has offered a price as low as $9.50 per case. He would like to be able to buy from that wholesaler but exclusive territories prevent him from purchasing from the lower-priced supplier. (Testimony of James Reid Boylston III, Barnwell, S.C., May 14, 1985).

Of course, the Indiana, New York and South Carolina examples do not lead to the conclusion that all exclusive territories result in harm to competition. To the contrary, exclusive territories are deemed to be lawful until it is proven that in particular circumstances they are producing net anticompetitive effects. However, the price information presented to the Committee does demonstrate that the use of exclusive territories *can* have anticompetitive effects and that distribution monopolies must be examined on a case-by-case basis. The evidence also underscores the conclusion that there is no reason to confer special treatment upon exclusive territories in the malt beverage industry.

THERE IS BROAD OPPOSITION TO S. 412

The list of opponents to this measure is long and impressive, and it should carry substantial weight in Senate consideration of this bill. It includes the Consumer Federation of America, the American Bar Association, the National Association of Attorneys General, the Department of Justice, the Federal Trade Commission, Public Citizen, Consumers Union, the President's Consumer Affairs Adviser, the National Association of Retail Druggists, the National Grocers Association, the National Small Business Association, the Food Marketing Institute, the National Association of Convenience

Stores, the National Licensed Beverage Association, and numerous retailers of malt beverages. The testimony of these diverse and well-informed witnesses attests to and illustrates the adverse effects on consumers, small business and competition that enactment of this bill could facilitate. Their testimony also underscores the point that, even if the bill does not lead to potential negative effects on consumers and competition, it is simply and undeniably unnecessary. It adds nothing to the protection enjoyed by procompetitive or competitively-netural exclusive territories under antitrust law. It only contributes extra protection to particular exclusive territorial agreements that are on balance anticompetitive.

SUMMARY

The malt beverage industry is asking for special treatment under antitrust law, yet no case has been made for this extraordinary grant of privileged status. Special antitrust status—even where a case has been made—has been only grudgingly conferred by Congress and the courts. Although numerous groups and industries would like to be exempted or treated differently in some way under antitrust law, Congress has repeatedly reaffirmed that the antitrust laws constitute a broad charter of economic freedom and has granted special status only in the most compelling circumstances. As the National Commission for the Review of Antitrust Laws and Procedures stated, special antitrust status should be conferred only "where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose."* In this record, there is no shred of evidence that competition is unworkable in the malt beverage industry or that there is any overriding social policy that could be served by S. 412. Likewise, there is nothing to distinguish malt beverage distributors from the many other wholesale distributors of food and beverage products who all provide refrigeration, storage and transportation services. The case for special industry alteration of the antitrust laws to aid the malt beverage industry just does not exist. The bill, S. 412, is special interest legislation that is unwarranted and unwise. It threatens to lead to higher prices by immunizing the territorial monopolies of beer wholesalers from antitrust challenge. It is at best unnecessary, and at worst it undercuts the ability of antitrust enforcement to preserve the Nation's free market economy.

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*National Commission For the Review of Antitrust Laws and Procedures, Report to the President and the Attorney General 177(1979).